MOODY'S
INVESTORS SERVICE

# Rating Action: Moody's downgrades University of Alaska (AK) to Baa1 and Baa3; outlook is negative

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New York, July 17, 2019 -- Moody's Investors Service has downgraded University of Alaska's (AK) General Revenue Bonds to Baa1 from A1, with $270 million outstanding, and the Series 2012 Lease Revenue Bonds to Baa3 from A2, with $23 million outstanding. The Lease Revenue Bonds were issued through Community Properties Alaska, Inc. The outlook for both the general revenue bonds and the lease revenue bonds is negative. This concludes our rating review initiated on July 2, 2019.

RATINGS RATIONALE

The multi-notch downgrade for both the revenue bonds and the lease revenue bonds reflects the severity and magnitude of the financial challenges confronting University of Alaska (UA) following an over 40% cut in the university's appropriations from the State of Alaska (Aa3 stable) for the current fiscal year, 2020. The state legislature did not override the governor's line item veto during the special session that ended on Friday, July 12, and UA's board has not yet acted to declare financial exigency, which would enable it to more quickly make programmatic and faculty reductions.

With this unprecedented single year cut in state appropriations, there is a high likelihood of a material reduction in the university's liquidity over the next year as it uses cash to fund programs pending restructuring of operations, and for the associate costs of that restructuring. UA's strategic position has been materially impaired by this funding reduction, as well as a cut to the state's financial aid programs, and we expect a multi-year negative impact on enrollment, which was already declining, as well as the competitive position of University of Alaska's research enterprise.

The ratings incorporate the university's $253 million of unrestricted monthly liquidity, which provides moderate flexibility to undertake the radical changes that will be necessary to adjust to this funding reduction. Further, UA has demonstrated some ability to reduce expenses, over 10% from fiscal 2016 to 2018, with contingency plans developed for reductions of about half the ultimate size that was passed.

The widening of the notching between the lease revenue bonds and the general revenue bonds reflects the subordinated nature of the obligation with a heightened risk of non-appropriation due to the university's significant financial challenges and the single asset nature of the lease (a dining facility on the Fairbanks campus).

RATING OUTLOOK

The negative outlook reflects execution risk as University of Alaska implements significant changes to a complex and sprawling system. The university is confronting both an immediate operational and liquidity challenge as well as a multi-year period of redefinition even as it takes into consideration multiple stakeholders, both mission-related and political considerations, and contractual constraints to rapid expense reductions. With significant uncertainty around the pace of action and resulting impact on financial results and liquidity, future rating actions could be multi-notch.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Demonstrated ability to quickly and sustainably respond to funding reductions without depleting liquidity could return the outlook to stable

- An upgrade would be dependent on evidenced ability to materially improve strategic position, either through restoration of stronger state support or through strengthening of other funding streams, such as tuition revenue and philanthropy

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Inability to act quickly to right-size operations without depleting liquidity

- Any indication of reduced willingness to honor debt or other contractual obligations

LEGAL SECURITY

The General Revenue Bonds have a senior claim on UA's University Receipts, which totaled $233 million in fiscal 2016. University Receipts are comprised of student tuition and fees, charges and rentals excluding government appropriations, gift, investment earnings and revenues from trust land required to be deposited in the Land Grant Endowment Trust Fund. There is a common debt service reserve fund of half of the maximum annual debt service for all outstanding bonds, as well as an additional bonds test. There is a rate covenant of the greater of a) the sum of the fiscal year debt service; the amount to be paid, if any, to the debt service reserve fund; the repayment any draws from the debt service reserve fund; and any other payments UA is required to make out of pledged revenues for the year; or b) two times annual debt service for the fiscal year.

The Series 2012 Lease Revenue Bonds, which were issued for a dining facility at the Fairbanks campuses, are a subordinate obligation to the general revenue bonds. The university is able to terminate the lease if the State fails to appropriate sufficient funds within any annual budget to pay the lease by providing written notice to the issuer (Community Properties Alaska, Inc.) and trustee within 10 business days of the enactment of the budget. There is no debt service reserve fund.

PROFILE

The University of Alaska, a land- sea- and space-grant system, was established in Fairbanks by Congress in 1915 as the Alaska Agricultural College and School of Mines. It operates campuses throughout the state, including urban campuses in Fairbanks (UA's organized research hub), Anchorage and Juneau, each with distinct academic programs. UA provides all levels of higher education, including certificates, associates and baccalaureate programs.

METHODOLOGY

The principal methodology used in these ratings was Higher Education published in May 2019. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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